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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

NORTHSTAR FINANCIAL ADVISORS, INC., on behalf of itself and all others similarly situated, Plaintiff, v. SCHWAB INVESTMENTS; MARIANN BYERWALER, DONALD F. DORWARD, WILLIAM A. HASLER, ROBERT G. HOLMES, GERALD B. SMITH, DONALD R. STEPHENS, MICHAEL W. WILSEY, CHARLES R. SCHWAB, RANDALL W. MERK, JOSEPH H. WENDER and JOHN F. COGAN, as Trustees of Schwab Investments; and CHARLES SCHWAB INVESTMENT MANAGEMENT, INC., Defendants.	Case No. 08-cv-04119-LHK CLASS ACTION **DEFENDANTS' NOTICE OF MOTION AND MOTION TO DISMISS FOURTH AMENDED COMPLAINT** Date: October 1, 2015 Time: 1:30 P.M. Courtroom: 8, 4th Floor, San Jose Judge: Hon. Lucy H. Koh

NOTICE OF MOTION AND MOTION TO DISMISS FOURTH AMENDED COMPLAINT

TO NORTHSTAR FINANCIAL ADVISORS, INC. AND ITS COUNSEL OF RECORD: PLEASE TAKE NOTICE THAT, on October 1, 2015, at 1:30 PM or as soon thereafter as the matter may be heard, in Courtroom 8, Fourth Floor, Defendants Schwab Investments, Charles Schwab Investment Management, Inc., Mariann Byerwaler, Donald F. Dorward, William A. Hasler, Robert G. Holmes, Gerald B. Smith, Donald R. Stephens, Michael W. Wilsey, Charles R. Schwab, Randall W. Merk, Joseph H. Wender and John F. Cogan will, and hereby do, move for dismissal of the complaint in this action pursuant to Rule 12 of the Federal Rules of Civil Procedure and Civil Local Rule 7-2.

This motion is based on this notice of motion, the memorandum set forth below, the accompanying declaration of Joshua D. N. Hess, the accompanying request for judicial notice, the reply memorandum, the pleadings and papers on file in this action, and such other written or oral argument as may be presented before the motion is taken under submission by the Court.

STATEMENT OF ISSUES

(Civil Local Rule 7-4)

1. Whether any or all of Plaintiff's claims are precluded by the Securities Litigation Uniform Standards Act (SLUSA) because they are brought on behalf of more than 50 people, are based on state law, and allege misrepresentations or omissions of a material fact in connection with the purchase or sale of a covered security.

2. Whether Plaintiff's claims for breach of fiduciary duty (Counts 1, 2, 8, and 9) or aiding and abetting a breach of fiduciary duty (Counts 3, 4, 10, and 11) are exempt from SLUSA preclusion under the so-called "Delaware carve-out" even though they do not meet the statutory definition of "permissible actions" that are subject to the Delaware carve-out.

3. Whether Plaintiff can invoke the "Delaware carve-out" to shield its claims for breach of fiduciary duty against Charles Schwab Investment Management, Inc. (Counts 2 and 9), when those claims, brought by a New Jersey plaintiff against a California defendant, cannot properly be asserted under Massachusetts law.

4. Whether Plaintiff's breach of fiduciary duty claims against the Trustees (Counts 1 and 8) are barred by the statute of limitations because they were first asserted more than three years after the facts were publicly disclosed and Plaintiff acquired actual knowledge of the alleged injury.

5. Whether Plaintiff's breach of fiduciary duty claims against Schwab Investments (Counts 1 and 8) and/or Charles Schwab Investment Management, Inc. (Counts 1 and 8) fail because neither Defendant owed a fiduciary duty to the shareholders.

6. Whether Plaintiff's breach of fiduciary duty claims against any or all Defendants (Counts 1, 2, 8, and 9) fail because Plaintiff has not adequately pleaded any breach.

7. Whether Plaintiff's claims against the Trustees are barred by the limitation of liability clause in the Declaration of Trust.

8. Whether Plaintiff's aiding and abetting claims (Counts 3, 4, 10, and 11) fail because Plaintiff has not adequately pleaded any underlying breach of fiduciary duty, actual knowledge of such a breach, or active participation in such a breach.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

INTRODUCTION

Like its four predecessors, Plaintiff's Fourth Amended Complaint ("4AC"), ECF No. 214, fails to state a claim against any of the Defendants. All five of Plaintiff's complaints have been attempts to plead state-law causes of action against the Defendants involving the same two purported misrepresentations, which allegedly induced prospective and current shareholders to buy and/or continue to hold shares in the Total Bond Market Fund (the "Fund"). Specifically, all five complaints allege that the Fund's 1997 Proxy and every subsequent prospectus issued between 1998 and 2009 falsely represented to shareholders that the Fund (1) would track the Lehman Brothers U.S. Aggregate Bond Index and (2) would not invest more than 25% of its assets in collateralized mortgage obligations. Although, as this Court has observed, this theory presents a classic securities misrepresentation claim, neither the Plaintiff nor any other Fund shareholder has *ever* pursued a federal securities claim under either the 1933 or 1934 Act, no doubt in large part because shareholders would recover little or no damages under those statutes. Indeed, Henry Holz, whose claim Plaintiff purports to assert, actually profited on his brief investment in the Fund.

In a stroke of creativity spawned by necessity, Plaintiff has eschewed the traditional federal securities laws and instead has premised its entire case on state law. However, as this Court has previously recognized (and the Ninth Circuit left conspicuously undisturbed), all of these claims are precluded by the Securities Litigation Uniform Standards Act ("SLUSA"). Although Plaintiff has attempted to avoid SLUSA preclusion by deleting overt references to "misrepresentations," such wordsmithing cannot change what this Court has noted was and continues to be the "central theme" of Plaintiff's claims: "[D]efendants made misrepresentations about how investments in the Fund would be managed, that Plaintiffs purchased Fund shares relying on these misrepresentations, and that Plaintiffs were injured when these statements turned out to be false." *Northstar Fin. Advisor, Inc. v. Schwab Invs.*, 781 F. Supp. 2d 926, 934 (2011) ("*Northstar I*"). Just as clearly, Plaintiff's recent protestations to the contrary notwithstanding, nothing has changed in the law or the public policy regarding SLUSA to suggest this Court should reverse its prior views. Consequently, the 4AC is precluded entirely by SLUSA.

The breach of fiduciary duty claims in the 4AC should also be dismissed in their entirety for additional reasons. The 4AC should be dismissed as to all Defendants because it fails to allege any breach of duty other than a violation of the Investment Company Act, which cannot, as a matter of law, provide the basis of a breach claim. In addition, there are separate and independent grounds to dismiss the fiduciary duty claim with respect to certain Defendants:

Schwab Investments/Charles Schwab Investment Management: the fiduciary duty claim in the 4AC must be dismissed because the 4AC does not establish that either of these entities owed a fiduciary duty to Fund shareholders.

Trustee Defendants: The fiduciary breach claims against the Trustee Defendants must be dismissed because they are barred by the statute of limitations and the liability bar in the Fund's Declaration of Trust.

Finally, the 4AC's claims for aiding and abetting fiduciary breach must fail with respect to all Defendants because Plaintiff fails to plead a primary violation and because it alleges none of the other required elements for those claims.[1]

This is the Plaintiff's *fifth* attempt to state a claim and Defendants' *fourth* motion to dismiss. Plaintiff has had far more than sufficient opportunity to plead its case. The 4AC should be dismissed with prejudice and without any further leave to amend.

BACKGROUND

The Fund is one of a series of mutual funds issued by Schwab Investments (the "Trust"), a Massachusetts business trust.[2] 4AC ¶ 3. The Fund was previously a government bond fund, but

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[1] Given the complexities caused by the assertion of unique claims and defenses that apply to some, but not all, Defendants, Defendants have prepared a short chart summarizing which Defendants assert each of the defenses raised in this motion. *See* Ex. N to the Declaration of Joshua D. N. Hess ("Hess Decl."), filed herewith.

[2] The 4AC is expressly based on the Fund's 1997 Proxy Statement and "subsequent SEC filings." *Id.* ¶ 185. The principal additional SEC filings referred to in the 4AC are the Fund prospectuses and Statements of Additional Information ("SAIs"). All of these documents are publicly available materials filed with the SEC and subject to judicial notice. It is appropriate to consider materials on a motion to dismiss where those materials are expressly referred to and incorporated into the allegations in the complaint or where they are subject to judicial notice. *U.S. v. Ritchie*, 342 F. 3d 903, 908-08 (9th Cir. 2003). Here all of these filings make up "[t]he terms of [the] contract" that Northstar believes Defendants have breached and thus

the shareholders approved a restructuring of the Fund in the Fall of 1997. *Id.* ¶ 83. As set forth in the July 25, 1997 Proxy Statement ("1997 Proxy"), the newly-restructured Fund was renamed the Total Bond Market Index Fund and its investment objective was revised to "attempt to provide a high level of current income consistent with preservation of capital by seeking to track the investment results" of the Lehman Brothers U.S. Aggregate Bond Index (the "Index"). *Id.* ¶ 84 (quoting the 1997 Proxy). This revised objective is the basis for the first of two alleged misrepresentations on which the 4AC and all of its predecessors are based. The 1997 Proxy made clear, however, that the Fund would only "seek to track the investment results" of the Index, rather than the *investments* in the Index, because not all securities included in the Index are publicly available. *Id.* ¶¶ 4, 84 (quoting the 1997 Proxy). Indeed, the 1997 Proxy made several important disclosures to the shareholders regarding its ability to "track" the results of the Index: (1) the Fund's assets could be invested in securities not included in the Index (Hess Decl. Ex. A (1997 Proxy) at 18); (2) the goal was to have 90% correlation between the performance of the Fund and the Index because "perfect correlation" was "unlikely to be achieved" (*id.* at 24); (3) "tracking error[s]" could "develop[ ]" that may require the Fund to "rebalance[ ]" (*id.*); (4) the "Fund [would] consider alternative arrangements" if a 90% correlation were "not achieved" (*id.*); and (5) the "Fund" intended to "purchase . . . significant amounts of mortgage-backed securities." *Id.* at 20. The 1997 Proxy also proposed, in the second purported misrepresentation on which this case has always been based, that the Fund would "not concentrate investments in a particular industry or group of industries . . . as concentration is defined under the Investment Company Act of 1940." *Id.* at 33. However, this proposed change was intended to apply a restriction that would be "more flexible" than the prior concentration limitations. *Id.* In addition, there was nothing in the fundamental policies that defined what was or was not considered an industry. *Id.* With the understanding that the Fund would only "seek" to track the "results" of the Index (but that differences were likely to occur) and that the Fund was adopting a "more flexible"

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may be considered. 4AC ¶ 185. Defendants' Request for Judicial Notice, filed concurrently with this motion, seeks judicial notice of Exhibits A-E attached to the Hess Declaration.

concentration restriction that did not define what constituted an industry, the shareholders approved of the change in investment objective.

Following the 1997 Proxy, the Fund continued to offer shares to prospective shareholders, like all open-ended mutual funds, through prospectuses filed with the SEC. From 1997 through February 2009, the end of the purported class period, the Fund filed dozens of revised prospectuses and related Statements of Additional Information ("SAIs") with the SEC, each offering Fund shares to shareholders based upon updated and materially different disclosures on a variety of topics, including the Fund's investment strategies, deviations from the Index, and concentration of assets in CMOs. *See, e.g.*, Hess Decl. Exs. A-E. But according to Plaintiff, each of those subsequently filed prospectuses repeated the same two alleged core misrepresentations regarding tracking and concentration policies and each of them induced shareholders to buy or hold shares. *See, e.g.*, 4AC ¶ 184 ("Subsequent to the 1997 proxy vote, Schwab Investments continued to offer shares in the Fund pursuant to the terms of a contract . . . these same terms were also included in Prospectuses and in Statements of Additional Information"); ¶ 185 ("The terms of the contract . . . were reiterated in Schwab Investments' subsequent SEC filings"). Plaintiff expressly pleads that the same two misrepresentations contained in every one of these filings form the very "contract" on which this case is based. *Id.*

From August 31, 1997, through August 31, 2007, the Fund's performance was consistent with the Index's performance and the Fund grew from $24 million in assets to approximately $1.5 billion. 4AC ¶¶ 108-09. During this time, the Fund repeatedly made public disclosures indicating that it was making investments in securities not contained in the Index. For example, in its January 1998 Prospectus, filed only a few months after the restructuring of the Fund and long before Henry Holz—Northstar's assignor—invested in the Fund, the Fund disclosed that only 65% of its assets would likely be invested in securities contained within the Index. *See* Hess Decl. Ex. B at 10. By 2002, the Fund was no longer guaranteeing that *any* of its assets would be invested in securities contained within the Index. *See* Hess Decl. Ex. C at 8 ("the fund is not required to invest any percentage of its assets in the securities of the index"). Around this time, the Fund also changed its name from the Total Bond Market Index Fund to simply the Total Bond

Market Fund. *See id*. All of these actions occurred, and were disclosed, five or more years before any alleged breach of fiduciary duty or contract in this case and yet the Fund continued to perform consistently with the Index. 4AC. ¶¶ 108-09.

Beginning in 2005—two years before Holz purchased shares in the Fund—the Fund began to disclose that it was increasing its investments in collateralized mortgage obligations ("CMOs"). Semi-annual reports explained that 2.7% of the Fund's portfolio was invested in CMOs on February 28, 2005, which rose to 3.6% on August 31, 2005 and then 12.8% on February 28, 2006. *See* Hess Decl. Ex. G at 6, 45; Ex. H at 6, 46; Ex. I at 6, 42.[3] During this time, the Fund regularly outperformed the Index. *Id.* The Fund decided to reduce its investment in CMOs to 11.9% by August 31, 2006, but this resulted in the Fund *underperforming* the Index. *Id.* Ex. J at 10, 40. The Fund increased its investment in CMOs to 17.7% on February 28, 2007, and, once again, reported that the Fund outperformed the Index. *Id.* Ex. K at 10, 41.

In February 2007, following the rising investment in CMOs and the corresponding improvement in performance, Holz purchased approximately 4,000 shares in the Fund. 4AC ¶ 29. Importantly, the November 2006 Prospectus, the prospectus Holz receive and pursuant to which he invested in the Fund, expressly warned all current and prospective shareholders that "the fund uses the index as a guide in structuring the fund's portfolio and selecting its investments. *However the fund is not required to invest any percentage of its assets in the securities represented by the index*." Hess Decl. Ex. D at 14 (emphasis added). This prospectus specifically warned that if the non-Index securities in which the Fund invested were to underperform then this could cause a "gap between the performance of the fund and that of the index." *Id.* at 17. The July 2007 Prospectus, sent to all current and prospective shareholders *after* Holz had invested in the Fund, repeated these warnings. Hess Decl. Ex. E at 14, 17. And yet neither the existence of these warnings nor the publicly-disclosed rising investments in CMOs caused Holz to sell his shares. Instead, he continued to hold his shares, allegedly in reliance on the representations that the Fund would continue to "seek to track" the Index. 4AC ¶ 84.

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[3] The annual and semi-annual reports are expressly referenced, and thus incorporated into, the 4AC. *See* 4AC ¶ 53 (quoting semiannual reports that were "disseminated to shareholders").

Before Holz invested in the Fund, the Fund also disclosed that it believed that "mortgage-backed securities issued by private lenders and not guaranteed by U.S. government agencies or instrumentalities are not part of any industry for purposes of a fund's concentration policy. This means that a fund may invest more than 25% of its total assets in privately-issued mortgage-backed securities." Hess Decl. Ex. D at 6. The same disclosure was made again shortly after he invested in the Fund. *Id.* Ex. F at 6. Consistent with this publicly-disclosed guidance, on August 31, 2007, the Fund publicly disclosed that it had increased its investment in CMOs to 37%. 4AC ¶ 110. Although Plaintiff now contests that this investment decision was a breach of contract and fiduciary duties, Holz purchased his shares *after* the Fund publicly stated that it did not consider CMOs to be an industry and therefore would not apply the 25% concentration policy to CMOs . Nevertheless, he still continued to hold his shares after the Fund actually invested, and disclosed that it had invested, more than 25% of its assets in CMOs.

Ultimately, due in part to the sudden and unexpected decrease in the market value of various securities, including CMOs, as a result of the severe credit crisis that began in 2007, the portfolio declined in late 2007, causing the Fund to underperform the Index. The Fund reacted by following its plan under the 1997 Proxy and subsequent prospectuses to "rebalance" the Fund to attempt to bring it more "in line with the Index." Despite the challenging market environment in 2008-2009, the Fund still managed to outperform its peers and was able to begin tracking the results of the Index again by February 27, 2009. *Id.* ¶ 10.

PROCEDURAL HISTORY

This is Plaintiff's *fifth* attempt to plead any claim in this case. Despite the continually evolving articulations of its claims, each complaint alleged that Defendants represented, in numerous disclosures offering the Fund for sale to investors, that they would manage the Fund in a certain manner and they ceased to do so without informing shareholders or seeking their consent. Of particular relevance, in its Second Amended Complaint ("2AC"), ECF No. 127, Plaintiff asserted the same purely common law claims it now asserts in the 4AC. This Court dismissed all of these claims as precluded under SLUSA, finding that "the central theme of the [2AC] and all of Plaintiffs' claims is that defendants made misrepresentations about how

investments in the Fund would be managed, that Plaintiffs purchased Fund shares relying on these misrepresentations, and that Plaintiffs were injured when these statements turned out to be false." *Northstar I*, 781 F. Supp. 2d at 934. The Court granted plaintiffs leave to amend the breach of fiduciary duty and third-party beneficiary claims (for the sole purpose of clarifying under which State's law they were brought) in order to determine whether they satisfied the so-called "Delaware carve-out" to SLUSA preclusion, but the contract and breach of covenant claims were dismissed *with prejudice*. *Id.* at 938, 944.

Plaintiff subsequently filed a Third Amended Complaint ("3AC") ECF No. 181, alleging only breach of fiduciary duty, aiding and abetting, and third-party beneficiary claims. This time, pursuant to this Court's guidance that only claims based on Massachusetts law could possibly evade SLUSA preclusion, Plaintiff asserted that the fiduciary breach claims were actually based on Massachusetts law. 3AC ¶¶ 124, 133, 144, 150, 175, 185, 196, 202. Plaintiff also split its claims between two subclasses: the "Pre-Breach class," which consists of those shareholders who purchased their shares prior to August 31, 2007, and chose to retain those shares following the disclosure that the Fund had invested 37% of its assets in CMOs; and the "Breach" class, which consists of those shareholders who purchased their shares after August 31, 2007, with full knowledge of the Fund's large investment in CMOs. *Id.* This Court dismissed all of the 3AC's claims with prejudice on the grounds that they were derivative claims and Plaintiff had not established that the shareholders were intended third-party beneficiaries of the Investment Advisory Agreement ("IAA") between the Fund and Charles Schwab Investment Management, Inc., the Fund's advisor (the "Advisor"). *See generally Northstar Fin. Advisors, Inc. v. Schwab Invs.*, 807 F. Supp. 2d 871 (N.D. Cal. 2011) ("*Northstar II*"). In dismissing the 3AC, the Court recognized that "[a]lthough Northstar has amended its Complaint three times, *its core allegations remain the same*." *Id.* at 872 (emphasis added). The Court did not address Defendants' renewed arguments under SLUSA.

On April 28, 2015, the Ninth Circuit reversed certain holdings of this Court that dismissed claims under the 2AC and 3AC. Specifically, the Ninth Circuit held that (1) Plaintiff could directly assert breach of fiduciary duty claims against the Trustee defendants, (2) SEC disclosure

documents, including the 1997 Proxy, created a contract under which the Fund agreed to manage the Fund pursuant to set investment objectives and concentration limits, and (3) Plaintiff had adequately pleaded that the Fund's shareholders were intended beneficiaries of the IAA. *Northstar Fin. Advisors, Inc. v. Schwab Invs.*, 779 F.3d 1036 (9th Cir. 2015) ("*Northstar III*"). The Ninth Circuit expressly declined to consider, let alone disturb, this Court's prior rulings regarding SLUSA preclusion, instead leaving that determination to this Court on remand. *Id.* at 1050.

On June 25, 2015, Northstar filed the 4AC, which asserts the same claims as the 3AC, but also re-pleads the breach of contract and breach of covenant claims from the 2AC that this Court had previously held were precluded by SLUSA. The breach of fiduciary duty and aiding-and-abetting claims are pleaded under Massachusetts law while the remaining claims are all asserted under California law. The core factual predicate of this case—the two alleged misrepresentations—remains virtually unchanged from the 2AC, which this Court held was precluded under SLUSA. The only thing that has changed is a transparent effort in the 4AC to avoid SLUSA preclusion by deleting Plaintiff's previously chosen characterization of the 1997 Proxy and subsequent prospectuses as containing "misrepresentations" and providing "assurances." The content of those same filings, of course, has not changed a whit.

LEGAL ARGUMENT

I. All Of Plaintiff's Claims Are Barred By SLUSA

The 4AC is a prime example of a plaintiff attempting to artfully plead its way out of SLUSA's reach by merely striking words such as "misrepresentation," but otherwise leaving precluded claims intact. As with Plaintiff's four prior complaints, the gravamen of all of its claims in the 4AC is that Defendants misrepresented the investment strategy of the Fund, both in the 1997 Proxy and in subsequent prospectus offerings to shareholders, both prior to and throughout the class period. According to all five complaints, shareholders not only bought, but held, Fund shares in reliance on those purported misrepresentations. Plaintiff is thus attempting to "assert[] what were essentially federal securities law claims as state law causes of action," even

though such gamesmanship is the precise practice that SLUSA was intended to "end." *Northstar I*, 781 F. Supp. 2d at 933.

As this Court has already recognized, "SLUSA prohibits class actions brought on behalf of more than 50 people . . . if the action is based on state law and alleges (a) a misrepresentation or omission of a material fact in connection with the purchase or sale of [a] covered security; or (b) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." *Id.* at 933. There is no dispute that: (1) this case is a purported class action of more than 50 people; (2) shares in the Fund are "covered securities" within the meaning of SLUSA; and (3) Plaintiffs have asserted exclusively state law claims. The only remaining question is whether Plaintiffs have alleged "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" and this Court has already correctly concluded that each of Plaintiffs' claims satisfies this element of the statute as well. Although the 4AC uses new language to characterize its claims, the substance of the claims themselves remain unchanged from the 2AC.

A. Plaintiff's Claims Are Based On Allegations They Either Purchased Or Retained Shares In Reliance On Misrepresentations Of The Fund.

The test of whether a claim is precluded under SLUSA is not one that turns on whether the word "misrepresentation" is used. Instead, courts must "look to the substance of the allegations" and "plaintiffs cannot avoid preclusion through artful pleading that removes the covered words . . . but keeps the covered concepts." *Freeman Invs., L.P. v. Pac. Life Ins. Co.*, 704 F.3d 1110, 115 (9th Cir. 2013) (internal quotation omitted); *see also Tuttle v. Sky Bell Asset Mgmt., LLC*, 2010 WL 4807093, at *5 (N.D. Cal. Nov. 19, 2010) ("Plaintiffs cannot avoid SLUSA by utilizing artful drafting which refrains from using the exact words 'misrepresentation' or 'omission.'").[4]

A comparison of claims previously dismissed as precluded under SLUSA in this case and the 4AC reveals that Plaintiff's central theme has not changed since the inception of this case.

[4] At the case management conference held on June 24, 2015, Plaintiff cited *Freeman Investments* for the incorrect proposition that contract claims purportedly cannot be precluded by SLUSA. But *Freeman Investments* could not be more explicit in stating that SLUSA "bars class actions brought under state law, whether styled in tort, *contract* or breach of fiduciary duty." 704 F.3d at 1114 (emphasis added).

Plaintiff's initial complaint made clear that its claims were premised on purported misrepresentations that Defendants made about the Fund's investment objectives (Complaint ("Compl."), ECF No.1, ¶¶ 32-34, 36-42, 44-45, 47-51, 54, 64-67, 69), that "Northstar. . . relied on Charles Schwab & Co., Inc.'s representations as to the Fund's investment objectives," and that those representations were false because the Fund actually violated the investment objectives. *Id.* ¶ 12. The initial complaint also expressly pleaded that Defendants' disclosure that CMOs are not an "industry," and thus the 25% concentration limit did not apply, was a fraudulent statement because Defendants purportedly knew this disclosure to be false at the time it was made. *Id.* ¶¶ 78, 79.

After the Ninth Circuit ruled that Plaintiff had no viable claim under the ICA and returned the case to this Court, Plaintiff continued to assert the same misrepresentation-based claims in the 2AC, now relying solely on state-law causes of action based on contract and breach of fiduciary duty theories. As summarized in Defendants' motions to dismiss the 2AC, Plaintiff made the following allegations:

> Northstar alleges the fund issued a proxy statement representing it would attempt to provide high current income and preservation of capital using an indexing strategy and it "assured" investors it would carefully analyze the characteristics of each security it sold. [2AC ¶¶50, 77] The proxy statement, says Northstar, "represented" that the fund would "seek a 90% correlation" between the fund and its index, and that this strategy would not increase the fund's risk profile. [*Id.* ¶¶58, 61] Northstar also alleges that the fund was marketed to investors as a conservative investment. [*Id.* ¶¶78, 81] These representations later allegedly were proved false because the fund deviated from its stated objectives. [*Id.* ¶¶95-96] Indeed, according to Northstar, the fund later offered investors a false explanation when its share price began to decline. [*Id.* ¶ 97]

Motion to Dismiss Second Amended Complaint at 7. ECF No. 150.

On the basis of these allegations, this Court correctly concluded that "the central theme of the [2AC] and all of Plaintiffs' claims is that defendants made misrepresentations about how investments in the Fund would be managed, that Plaintiffs purchased Fund shares relying on those misrepresentations, and that Plaintiffs were injured when these statements turned out to be false." *Northstar I*, 781 F. Supp. 2d at 934. Based on Plaintiff's insistence that it could replead these claims, this Court granted Plaintiff leave to amend.

Plaintiff has now filed two additional amended complaints (their fourth and fifth complaints in this action), but neither changes the central theme of their case. Although the Court did not reach the issue of SLUSA preclusion with respect to Northstar's first attempt to avoid SLUSA (the 3AC), the Court correctly observed with respect to that complaint that "[a]lthough Northstar has amended its Complaint three times, *its core allegations remain the same*." *Northstar II*, 807 F. Supp. 2d at 872 (emphasis added). With the 4AC, that fact has not changed.[5] Like the precluded 2AC, the 4AC still alleges that the Fund issued a proxy statement representing that it would follow an indexing strategy; that there would be a 90% correlation between the Fund and the Index; and that the indexing strategy would not increase the Fund's risk profile. *See id.* ¶¶ 89, 163(c). The only change to these allegations is Plaintiff's removal of specific language about "informing" or "assuring" investors. And the 4AC still alleges that these representations were proved false because the Fund, in actuality, did not follow the investment objectives that had been repeatedly represented to the shareholders. *See, e.g.*, *id.* ¶¶ 5, 110, 118, 258. Further, the 4AC pleads that even after these representations were proved false, shareholders continued to hold or purchase shares in reliance on these false representations, which were repeated in subsequent SEC filings. *See id.* ¶ 186. This Court previously pointed to each of these allegations in the 2AC to support dismissal under SLUSA, and it should do so again. *Northstar I,* 781 F. Supp. 2d at 934-936.

In fact, the 4AC includes additional allegations that the Defendants made untruthful representations to the Fund's shareholders. Plaintiff specifically alleges that Defendants "had knowledge superior to the Fund's shareholders regarding the composition of the Fund's holdings and the compliance with the Fund's fundamental investment objectives and policies" and thus had a "duty to deal fairly, honestly and in good faith with plaintiff and the other member Class members," but breached that duty. *See* 4AC ¶¶129-130. Defendants purportedly made *repeated* representations in various prospectuses, proxies, statements of additional information, and

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[5] Indeed, Plaintiff concedes that there is no difference between the 4AC and 3AC, other than the reinsertion of the previously dismissed contract claims and "wordsmithing." *See* Motion for Leave to File Fourth Amended Complaint (ECF No. 206) at 1.

marketing materials from 1997 until the end of the class period that shareholders could "trust" Defendants to follow particular investment objectives. *See id.* ¶ 53 ("All defendants repeatedly assumed fiduciary duties in SEC filings disseminated to shareholders and repeatedly thanked investors for placing their 'trust' in Schwab"). Further, Plaintiff's claims are not based on a single "contract" but on various statements that were made in multiple prospectuses, registration statements, and SAIs throughout the class period in which Defendants purportedly "reiterated" the representations made in the 1997 Proxy Statement. *See Id.* ¶ 185 (terms of 1997 proxy statement "reiterated" in " Schwab Investments' subsequent SEC filings . . . and in *each* subsequent Prospectus and Statement of Additional Information") (emphasis added); *id.* ¶ 188 (noting that Defendants promised they would not "deviate[ ] from the composition of the [Index]" in "the 1997 Proxy Statement and subsequent prospectuses and SAIs"). Even though Plaintiff believes that the Fund was no longer following its investment objectives by August 2007, thus rendering any statement suggesting compliance with the objectives untrue, Plaintiff specifically alleges that certain class members purchased new shares after this point (the "Breach" class) and the remaining class retained their shares beyond this point (the "Pre-Breach" class) all in reliance on these continuing, and purportedly false, representations made through the end of the class period in 2009. *See id.* ¶ 186 ("existing investors retained shares and new investors purchased shares *in consideration* of the contractual obligation not to change fundamental investment objectives without a shareholder vote") (emphasis added).[6]

This Court has already ruled that these same allegations, as stated in the 2AC, are barred by SLUSA. In their second attempt to fix that fatal flaw, Plaintiffs have now alleged vaguely what was previously alleged directly: Plaintiff seeks to represent a class of people who, relying

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[6] Additional evidence that Plaintiff intends to avoid SLUSA by litigating a securities fraud case under the guise of common-law tort and contract claims can be found in other documents recently generated in this litigation. For example, Plaintiff has recently served a request for the production of "[a]ll documents concerning any *allegations of misrepresentation*" regarding "the manner in which [the fund] was sold or promoted" as well as six additional requests that exclusively seek statements and representations made in Defendants' marketing materials. *See* Hess Decl. Ex. M (Plaintiff's First Request For Production Of Documents) Nos. 15, 76-81.

on representations that the Fund would "seek to track" the performance of the Index and would not invest more than 25% in any particular industry, invested and/or retained shares in the Fund. Although Plaintiff now asserts that some of these representations may have been true when they were made, Plaintiff alleges they were untrue by August 31, 2007, when the Fund publicly disclosed it had invested 37% of its assets in CMOs, at which point shareholders in the "Breach" class purchased their shares and shareholders in the "Pre-Breach" class decided to retain their shares in reliance on these allegedly false statements.[7] Setting aside the issue of whether it is plausible that any shareholder was relying on these purportedly false or misleading representations at a time when the Fund's actual investments were a matter of public knowledge, SLUSA makes clear that these claims must be pleaded under the federal securities laws and not as the state-law claims asserted here.

B. The Misrepresentations Alleged In The 4AC Were Allegedly Made "In Connection With" The Sale Of A Covered Security.

It is well-established that the phrase "in connection with the sale of a covered security" is intended to have a broad construction and this element is satisfied so long as the misrepresentation "coincide[s] with a securities transaction—whether by the plaintiff or by someone else." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,* 547 U.S. 71, 85-86 (2006). As this Court has recognized, this broad construction includes "holder" claims where, as here, "Plaintiffs . . . purchased stock 'before any relevant misrepresentation' and were only injured by not later selling the stock due to alleged misrepresentations." *Northstar I*, 781 F. Supp. 2d at 937 The "Pre-Breach" class asserts only "holder" claims on behalf of the shareholders who continued to hold their shares beyond August 31, 2007, in reliance on reaffirmed representations that

[7] This Court has already ruled that even if Plaintiff takes the position that the alleged misrepresentations were true statements at the time they were made, that position does not save the claims from SLUSA preclusion because the class definition includes people who purportedly relied on these statements after the point where they became untrue. *See Northstar I*, 781 F. Supp. 2d at 936 ("Even if Plaintiffs now allege the statements were true at some point, the class definition starts the clock for the class claims at the moment Plaintiffs allege the statements became untrue—'from August 31, 2007, through February 27, 2009'"). Plaintiff still asserts the same class period and does not even attempt to respond to the Court's sound conclusion on this issue.

purportedly were no longer true. The Breach class even more obviously alleges claims based on misrepresentations "in connection with the sale of a covered security" because the reaffirmed statements from the 1997 Proxy Statement and subsequent prospectuses were already allegedly untrue at the time those shareholders purchased their shares. As previously recognized, "Plaintiffs assert almost no support for [their] position [that this element has not been satisfied], and there is little to be found." *Id.* The 4AC makes no attempt to improve Plaintiffs' argument on this issue.

C. Plaintiff's Claims Are Not Saved By The "Delaware Carve-Out."

The so-called "Delaware carve-out," as set forth in 15 U.S.C. § 77p(d), allows a Plaintiff to bring certain "permissible actions" that would otherwise be precluded by SLUSA only when the Plaintiff asserts class action claims under "the statutory and common law of the State in which the issuer is incorporated or organized." 15 U.S.C. § 77p(d)(1)(A). However, even if a claim is asserted under the law of the issuer's State of incorporation, only a select few categories of cases meet the statutory definition of "permissible actions." 15 U.S.C. § 77p(d)(1)(B). As summarized by the Ninth Circuit, a "permissible action" for purposes of the Delaware carve-out must meet *all* of the following elements: "(1) a "recommendation, position, or other communication with respect to the sale of securities," (2) "made by or on behalf of" the issuer or its affiliate to the shareholders of the issuer, and (3) "concern[ing]" shareholder decisions "with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights." *See Madden v. Cowen & Co.*, 576 F.3d 957, 969 (9th Cir. 2009). Contrary to Plaintiff's assertion that *all* of its "causes of action fall under the 'Delaware Carve-Out'" (4AC ¶ 72), Plaintiff has not alleged a factual basis that would allow the Delaware carve-out to save any of its claims.

1. The Delaware Carve-Out Does Not Apply To The Breach Of Contract, Breach Of Covenant, And Third-Party Beneficiary Claims Against All Parties Because They Are Not Asserted Under Massachusetts Law.

As a threshold matter, the Delaware carve-out applies only when claims are asserted under the laws of the State in which the issuer is incorporated. The issuer in this case—the Fund—is a Massachusetts business trust and so the Delaware carve-out could conceivably apply only to

claims asserted under Massachusetts law. But only Plaintiff's breach of fiduciary duty and aiding-and-abetting claims (Claims 1-4, 8-11) are asserted under Massachusetts law. The remaining claims for breach of contract, breach of covenant of good faith and fair dealing, and third-party beneficiary are explicitly asserted under *California* law. 4AC ¶ 19.[8] As a matter of law, the Delaware carve-out cannot possibly save the claims asserted under California law from SLUSA preclusion.

2. The Delaware Carve-Out Also Does Not Apply To The Breach Of Fiduciary Duty Claims Asserted Against The Advisor Because They Are Not Properly Asserted Under Massachusetts Law.

The Delaware carve-out also cannot apply to the breach of fiduciary duty claims against the Advisor for the separate reason that those claims are not properly brought under Massachusetts law. Plaintiff "predicat[es]" its two claims for breach of fiduciary duty against the Advisor (Claims Three and Nine) on Massachusetts law (4AC ¶¶ 136, 206), but does not plead any facts that would establish a basis for Massachusetts law to apply to these claims. The 4AC pleads that Plaintiff is a resident of New Jersey (*id.* ¶ 23) and that the Advisor is a resident of California (*id.* ¶ 51). Even if Plaintiff could establish that the Advisor owed fiduciary duties directly to Plaintiff, which is not correct (*see infra* Section III), Plaintiff cannot establish how the breach of such a duty by a California company to a New Jersey plaintiff would be subject to Massachusetts law. Because the complaint pleads no facts that would justify application of Massachusetts law, California law applies by default. *See CRS Recovery, Inc.*, 600 F. 3d at 1143-44.

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[8] The 4AC includes a confusing allegation that "[i]nasmuch as Massachusetts law supports plaintiff's claims, plaintiff has no reason to believe a California state court would apply California substantive law to any claims that would otherwise be subject to Massachusetts law to protect an important California state public policy." 4AC ¶ 20. But the 4AC contains no allegation that the breach of contract, breach of covenant, or third-party beneficiary claims would actually be subject to Massachusetts law and, as Northstar acknowledges, absent the invocation of another State's law, California law applies by default. *Id.*; *CRS Recovery, Inc. v. Laxton*, 600 F.3d 1138, 1143-44 (9th Cir. 2010) ("Under California choice-of-law rules, the party seeking application of foreign law bears the burden to show that the law of a foreign state should apply. At the point [the party] fails to make this showing, we default to forum (California) law.").

Indeed, the primary source upon which Plaintiff bases the Advisor's purported fiduciary duty is the IAA between the Advisor and the Trust. 4AC ¶¶ 137-38. But the IAA contains an express choice-of-law clause stating that it "shall be governed by the laws of the State of California," which Plaintiff previously recognized. 2AC ¶ 159. Thus, to the extent that the IAA imposes any purported fiduciary duty on the Advisor with respect to Plaintiff, the IAA's choice-of-law clause requires California law to apply. *See Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 470 (1992) ("we hold a valid choice-of-law clause, which provides that a specified body of law 'governs' the 'agreement' between the parties, encompasses all causes of action arising from or related to that agreement, regardless of how they are characterized, including tortious breaches of duties emanating from the agreement or the legal relationships it creates").

Plaintiff's baseless attempt to invoke of Massachusetts law to cover this claim is plainly a tactical attempt to avoid SLUSA preemption, but it provides Plaintiff with no refuge because there are no facts or law to support a Massachusetts choice of law. Under California choice-of-law doctrine, which applies here, this claim must be asserted under the laws of either California or New Jersey because Plaintiff cannot establish why any other State would have an interest in applying its law to wholly-foreign parties and, accordingly, this claim cannot avoid SLUSA preemption under the Delaware carve-out.[9] *CRS Recovery*, 600 F.3d at 1143-44; n. 8, *supra*.

3. The Delaware Carve-Out Does Not Apply To Any Claim Because This Case Is Not A "Permissible Action," Even If Brought Under Massachusetts Law.

A determination that the claims are based on the laws of the State in which the issuer is incorporated is only the *beginning* of the analysis to determine whether the Delaware carve-out will spare an otherwise precluded claim under SLUSA.[10] 15 U.S.C. § 77p(d)(1)(B) is clear that

[9] At this time, it is not necessary to determine whether California or New Jersey law applies to this claim. It is sufficient to conclude that the claim is not properly brought under the laws of Massachusetts.

[10] This Court has not previously had an opportunity to consider each of the elements required under a full analysis of the Delaware carve-out because when Plaintiff initially raised this issue it incorrectly suggested to the Court that the only question was whether the claims were asserted under Massachusetts law. *See* Pl. Opp. to Mtn. to Dismiss Second Amended Compl. (ECF No. 158), at 21 n. 25. Although this standard was incorrect, at the time none of Plaintiff's claims had been asserted under Massachusetts law so a full analysis of the carve-

the Delaware carve-out applies only to certain "permissible actions," which include only two specific types of class actions. The first type, involving "the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity," is plainly inapplicable because this case does not involve the sale or purchase of shares "exclusively" with current shareholders. *Id.* Rather, the purchase of Fund shares was open to other Schwab customers and members of the public. The second type involves "any recommendation, position, or other communication with respect to the sale of securities of the issuer that (I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; *and* (II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights." *Id.* (emphasis added) Plaintiff also cannot establish that its claims fit within this second category.

This case does not involve a "tender or exchange offer" and it does not involve the exercise of dissenters or appraisal rights. Lacking any other viable option to characterize this case as a "permissible action," Plaintiff predictably pleads the bald legal conclusion in the 4AC that this case "relate[s] . . . to voting rights" (4AC ¶ 15), based on Plaintiff's belief that a shareholder vote *should* have occurred before the Fund invested more than 25% in CMOs. But this misstates the standard. Rather than applying to any case with any arguable and tangential connection to "voting rights,"[11] the statutory language limits "permissible actions" to those cases that "concern[ ] decisions of . . . equity holders with respect to voting their securities." This standard says nothing about "voting rights" but is, instead, focused on whether a vote that actually occurred was improperly influenced by misrepresentations. Here, no vote occurred and common sense

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out was unnecessary. Plaintiff has now filed an amended pleading, superseding all prior pleadings, and it is well-established that all applicable defenses may now be asserted. *See Massey v. Helman*, 196 F.3d 727, 735 (7th Cir. 1999) ("amended complaint opens the door for defendants to raise new and previously unmentioned affirmative defenses"); *see also Mattel, Inc. v. MGA Entm't, Inc.*, 782 F. Supp. 2d 911, 1017 (C.D. Cal. 2011).

[11] If Plaintiff's unsupported legal standard were law, every shareholder lawsuit would be able to avoid SLUSA merely by alleging that a vote should have occurred prior to the disputed corporate action. The statutory limitation on "permissible actions" would be meaningless.

dictates that the misrepresentations alleged in this case cannot "concern[ ] decisions" that were never made because it is undisputed that the putative class members were not asked to vote in the first place. Accordingly, for all the reasons set forth above, this case is not a "permissible action" within the meaning of the Delaware carve-out.[12]

A recent decision from this District, *Crimi v. Barnholt*, 2008 WL 4287566 (N.D. Cal. Sept. 17, 2008), is instructive. In *Crimi*, shareholders of KLA filed breach of fiduciary duty claims based on KLA's alleged failure to disclose that it had issued backdated stock options to its senior executives. The Court divided the claims into two categories: "holder" claims and "voting" claims. The "holder" claims were based on allegations that the failure to disclose this information had prevented the shareholders from "mak[ing] an informed decision concerning whether they should continue holding their shares," whereas the "voting" claims arose from allegations that the non-disclosure had deprived shareholders "of their ability to make an informed decision" regarding certain stock issuances and an executive compensation plan that were the subject of a shareholder vote. *Id.* at *3. The court held that the "holder" claims were precluded by SLUSA, but the "voting" claims were saved by the Delaware carve-out. Here, Plaintiff's breach of fiduciary duty claims directly resemble the "holder" claims in *Crimi* because Plaintiff alleges that the Fund's lack of transparency regarding its investment objectives caused the shareholders to purchase or hold their shares. 4AC ¶ 186. Unlike the "voting" claims in *Crimi*, where a vote was actually held and information was concealed from shareholders to influence the outcome, Plaintiff's entire claim in the 4AC is premised on the fact that there was no shareholder vote in the first place. *See, e.g.*, 4AC ¶ 4. If no vote was held, there could be no misrepresentations or omissions that could influence or manipulate the outcome of the vote. As

[12] The misrepresentations alleged in this case address the Fund's investment strategies without "directly discussing the sale of securities" and this distinction provides an additional basis to find that the carve-out does not apply. *Fisher v. Kansas*, 487 F. Supp. 2d 270, 280 (E.D.N.Y. 2007) *aff'd*, 288 F. App'x 721 (2d Cir. 2008). As recognized in *Fisher*, although SLUSA applies broadly to any case that has a "connection" to alleged misrepresentations, courts narrowly interpret the language limiting the Delaware carve-out to representations made "with respect to the sale of securities." *Id.* Plaintiff has not identified a specific misrepresentation that "directly discuss[es] the sale of securities" and, accordingly, cannot seek refuge within the Delaware carve-out. *Id.*

such, this case is not a "permissible action" and the Delaware carve-out does not apply. *See, e.g.*, *Huang v. Reyes* 2008 WL 648519, *5 (N.D. Cal. Mar. 6, 2008) ("the carve-out . . . appl[ies] where . . . the corporation issues proxy statements requesting that the shareholders vote").

II. Plaintiff's Breach Of Fiduciary Duty Claims Against All Defendants Fail Because Plaintiff Has Not Alleged Any Breach

In addition to being barred by SLUSA, the 4AC fails to sufficiently plead a breach of any fiduciary duty against any Defendant. Plaintiff pleads no facts to support its allegation that the Fund made inappropriately risky or speculative investments but, instead, bases its claims entirely on the rehashed assertion that Defendants breached their fiduciary duties by causing the Fund to change its investment objectives without first obtaining a shareholder vote. *See* 4AC ¶ 131. Even assuming *arguendo* that the Fund did change its investment objectives—and it did not—the only reason a shareholder vote would have been required is because of the statutory requirement found in Section 13(a) of the ICA. 15 U.S.C. § 80a-13(a). But, as previously recognized in this case, Plaintiff has no private right to enforce Section 13(a). *Northstar Fin. Advis., Inc. v. Schwab Invs.*, 615 F.3d 1106, 1115 (9th Cir. 2010). Accordingly, Plaintiff has re-pleaded the same claim as a breach of fiduciary duty claim in an attempt to create a private cause of action where none exists for this alleged statutory violation. The Massachusetts Supreme Court has made clear that the violation of a *statutory* obligation does "not amount to a breach of fiduciary duty." *O'Brien v. Pearson*, 449 Mass. 377, 385 n.7 (2007). Even if Plaintiff could prove facts demonstrating that any Defendant had violated the ICA, those same facts would not also establish an independent breach of fiduciary claim covering the same conduct. *See In re Charles Schwab Corp. Sec. Litig.*, 2009 WL 1371409, at *6 (N.D. Cal. May 15, 2009) (plaintiff "entirely fail[ed] to explain how the alleged violation of the [ICA] would activate any non-ICA fiduciary duties"). The ICA claim was dismissed and Plaintiff cannot resurrect it merely by alleging the exact same facts and conduct and calling it a breach of fiduciary duty.

When this argument was raised previously, Plaintiff primarily relied on *California* cases to support its Massachusetts breach of fiduciary duty claim. *See* Opp. to Mot. to Dismiss 3AC (ECF No. 185) at 11. Notably, however, each of these cases held that there had been a breach of

fiduciary based, in part, on allegations that the defendants had misrepresented or omitted material information. *See, e.g.*, *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445, 484 (1998) (fiduciary breach claim adequately pleaded because of alleged "active concealment" and "fraudulent misrepresentations"); *Terra Ins. Co. v. N.Y. Inc. Mgmt. LLC*, 717 F. Supp. 2d 883, 894 (N.D. Cal. 2010) (fiduciary breach claim adequately pleaded because of alleged failure to disclose material information).[13] Here, Plaintiff expressly and repeatedly disclaims that its claims are based on misrepresentations and omissions because, if they were, then they are precluded by SLUSA. Plaintiff cannot have its argument both ways: either Plaintiff has alleged misrepresentations and omissions that would result in its fiduciary duty claims being precluded by SLUSA or Plaintiff alleges only a violation of the ICA, which cannot serve as the basis for a fiduciary breach claim.[14]

III. Plaintiff's Breach Of Fiduciary Duty Claims Against The Trust And The Advisor Fail Because Plaintiff Has Not Established The Trust Or Advisor Owed Any Duty To The Shareholders

Although the Ninth Circuit has held that the *Trustees* owed fiduciary duties directly to the shareholders, it did not make any similar ruling with respect to the Trust itself or the Advisor. *Northstar III*, 779 F.3d at 1056-57 (addressing only whether the Trustees owed a fiduciary duty to the shareholders). It is axiomatic that if Plaintiff intends to assert a claim for breach of fiduciary duty against these Defendants directly then they must first adequately allege the existence of such a duty. *Swinden v. Vanguard Grp., Inc.*, 2009 WL 3415376, at *5 (N.D. Cal Oct. 21, 2009) ("An

[13] Plaintiff also relied upon inapplicable cases including *Grimmway Enters., Inc. v. PIC Fresh Global, Inc.*, 548 F. Supp. 2d 840, 847 (E.D. Cal. 2008), which dealt with an unopposed motion for summary judgment seeking to hold an individual liable as a control person for an entity whose liability was not in dispute, and *Copic Ins. Co. v. Wells Fargo Bank, N.A.*, 2010 WL 3059160 (D. Colo. Aug. 2, 2010), which dealt only with whether a party could seek punitive damages, did not involve a mutual fund, and did not address the sufficiency of a claim for fiduciary duty. *See* Opp. to Mot. to Dismiss 3AC (ECF No. 185) at 11.

[14] At minimum, Plaintiff cannot establish that Trustee Defendants Wender or Cogan breached their fiduciary duties because Plaintiff pleads that "the Schwab Trustees and Trust breached their fiduciary duties" by changing the investment objective and exceeding the 25% concentration limit "on or about August 31, 2007" (4AC ¶ 131), but Wender and Cogan did not become Trustees until June 2008, nearly a full year *after* the alleged breach. *Id.* at 45.

action for breach of fiduciary duty requires the plaintiff to allege the existence of a fiduciary relationship").

As this Court has already recognized, Plaintiff has previously conceded that neither the Trust nor the Advisor owe fiduciary duties directly to the shareholders as matter of law but, instead, tries to establish the existence such duties as a matter of fact. *See Northstar II*, 807 F. Supp. 2d at 876 ("Northstar argues that the Trustees owed fiduciary duties directly to Fund investors as a matter of law, and that the rest of the defendants owed fiduciary duties to the investors as a matter of fact."). But to plead the existence of a fiduciary duty as a matter of fact under Massachusetts law (which applies to the Trust) or California law (which applies to the Advisor), Northstar must plead facts sufficient to demonstrate a close and personal relationship between the defendant and the shareholder. *See, e.g.*, *Fernandes v. Havkin*, 731 F. Supp. 2d 103, 110 (D. Mass. 2010) (no fiduciary duty where "plaintiff and defendant lacked any direct relationship, certainly not one of deep, personal trust and respect"); *Petrell v. Rakoczy*, 2005 WL 1683600, at *4 (Mass. July 11, 2005) (no fiduciary duty where diocese "did not have any personal contact with the parishioners of each parish so as to create an awareness that individual parishioners relied upon them for guidance or advice"); *Petersen v. Sec. Settlement Corp.*, 226 Cal. App. 3d 1445, 1455 (Cal. App. 1991) (no fiduciary duty absent a "direct and personal relationship"). The 4AC is devoid of factual allegations suggesting that either the Trust or the Advisor ever held such a personal relationship with any shareholder, let alone all of them.

In an attempt to establish the existence of this relationship, the 4AC alleges that the Advisor sent generic marketing materials to the shareholders thanking them for their investment and using boilerplate marketing terms such as "we're working hard to uphold the best interests of our shareholders." 4AC ¶ 53. But such broadly distributed marketing materials do not create fiduciary relationships. *See Hamilton v. Allen*, 396 F. Supp. 2d 545, 553 (E.D. Pa. 2005) (rejecting argument that dissemination of advertising material with promise to "act in [shareholders'] full best interest" establishes a fiduciary duty). If the law were otherwise, nearly every service company, financial or otherwise, in the country could be said to have a fiduciary relationship with every individual who has ever received marketing materials from that company

regardless of whether the sender and recipient actually had a direct or personal relationship. Proof of an ongoing and personal relationship, beyond the mere delivery and receipt of marketing materials, are necessary in order to generate a fiduciary duty as a matter of fact. *See, e.g.*, *In re Hilson*, 863 N.E. 2d 483, 493 (Mass. 2007) (fiduciary duty exists as a matter of fact where "there is substantial evidence to support the conclusion that respondent was acting as an escrow agent for the broker and the seller"); *Doe v. Harbor Sch., Inc.*, 843 N.E. 2d 1058, 1062, 1064 (Mass. 2006) (fiduciary duty exists as a matter of fact between a "one-on-one counselor" and his ward where "the undisputed record leaves no doubt" that the counselor "was in a formal position of authority over [ward], and responsible, among other things, for her practical education in independent living"). Plaintiff does not adequately plead that a similarly close relationship existed between the Advisor or the Trust and every individual shareholder.

Plaintiff also alleges that the Advisor acquired a fiduciary duty simply by performing its function as an advisor to a mutual fund. 4AC ¶ 57-58. But, as Plaintiff expressly acknowledges, any services the Advisor provided to the Fund were the result of its contractual obligations under the IAA (4AC ¶ 138), which was heavily negotiated by independent, sophisticated parties and is reconsidered and renewed pursuant to federal law on an annual basis. Massachusetts law is clear that "[w]hen rights of stockholders arise under a contract . . . the obligations of the parties are determined by reference to contract law, and not by the fiduciary principles that would otherwise govern." *Chokel v. Genzyme Corp.*, 449 Mass. 272, 278 (2007). Plaintiff failed to cite any authority at all supporting the contrary position in prior briefing and, to Defendants' best knowledge, none exists. *See* Pl. Opp to Motion to Dismiss 3AC (ECF No. 185) at 8-10.

IV. Plaintiff's Breach Of Fiduciary Duty Claims Against The Trustee Defendants Are Barred By The Statute Of Limitations

The 4AC's fiduciary breach claims against the Trustee Defendants must also be dismissed for the additional reason that they are time-barred. As it concedes in the 4AC, Plaintiff's breach of fiduciary duty claim is subject to a three-year statute of limitations. 4AC ¶ 47; Mass. Gen. Laws ch. 260, § 2A. Plaintiff first added the Trustees as defendants in this lawsuit on September 28, 2010, meaning that Plaintiff's fiduciary breach claim against the Trustees is time-barred if it

arose prior to September 27, 2007. Plaintiff pleads that "beginning on or about August 31, 2007, the Schwab Trustees and Trust breached their fiduciary duties." 4AC ¶ 131. Plaintiff failed to assert its claim against the Trustees within three years after the alleged breach on or about August 31, 2007, and those claims are now time barred.

Recognizing that its claim is untimely, Plaintiff has now pleaded the legal conclusion that these claims should nevertheless be treated as timely because "[t]he deviation in the reported NAV for the Fund compared to the Index prior to September 28, 2007 was not greater than 1%, and certainly insufficient to establish plaintiff's actual knowledge of the claim against the Trustees prior to September 28, 2007." 4AC ¶ 47. This is not the appropriate trigger for the statute of limitations under Massachusetts law. For breach of fiduciary duty claims against trustees, the "injury" occurs at the time that the trustee allegedly repudiates the trust and the statute of limitations begins to run at the time the plaintiff acquires actual knowledge of that repudiation. *See, e.g.*, *Lattuca v. Robsham*, 442 Mass. 205, 213 (2004) ("we consistently have held that a cause of action for breach of fiduciary duty does not arise until the beneficiary is aware that repudiation has occurred"); *Demoulas v. Demoulas Super Mkts, Inc.*, 424 Mass. 501, 518 (1997) ("Our decisions . . . have consistently indicated that a cause of action does not accrue until the trustee repudiates the trust *and* the beneficiary has actual knowledge of that repudiation."). Here, Plaintiff claims that the Trustees breached their fiduciary duties, in part, by investing more than 25% of the Fund's assets in CMOs (4AC ¶¶ 6, 131), but the 4AC concedes that that deviation became public knowledge no later than August 31, 2007, when Defendants disclosed in a prospectus that 37% of the Fund's assets had been invested in non-agency CMOs. 4AC ¶ 110. The Fund's shareholders are charged with actual knowledge of the statements contained in this prospectus. *See In re Keyspan Corp. Sec. Litig.*, 383 F. Supp. 2d 358, 374 (E.D.N.Y. 2003) ("courts have recognized the SEC website as a 'recognized channel of distribution,' and have charged investors with knowledge of documents posted there"); *see also Topham v. State Street Corp.*, 957 N.E. 731, *2 (Mas. App. 2011) (citing *In re Keyspan*). Thus, even if Plaintiff had adequately pleaded a claim for breach of fiduciary duty (which, as set forth

supra, it did not), the 4AC proves Plaintiff knew about this claim more than three years before filing suit against the Trustees. Accordingly, the claim against the Trustees is time-barred.[15]

Plaintiff's assertion that it is afforded some unspecified grace period based entirely on the comparative performance of the Fund and the Index is not supported by Massachusetts law.[16] The important "policy reasons for the statute of limitations," including "minimiz[ing] the prejudice following from the passage of time" and avoiding the litigation of "stale" matters, would be hopelessly frustrated if a plaintiff, when the existence of facts believed to constitute a breach of fiduciary duty are known to him, could nonetheless wait until the realization of some unspecified degree of financial loss– an event that could have take years to occur if it ever occurs at all—before filing a claim. *Garabedian v. Schomer*, 622 N.E.3d 177, *2 (2014).

Plaintiff knew all the facts that it believes constitute a breach of fiduciary duty by August 31, 2007, but chose to wait more than three years before asserting any claim against the Trustees. The law does not permit such a delay. Plaintiff's breach of fiduciary duty claims against the Trustees are time-barred.

V. The Trustees Are Protected By A Limitation Of Liability Clause

The Schwab Investments Declaration of Trust, expressly incorporated into the 4AC (¶¶17, 98) provides that the Trustees are liable only for conduct arising from "willful malfeasance, bad faith, gross negligence, or reckless disregard" of their duties. Hess Decl. Ex. L, at Art. VII § 2. Plaintiff alleges no facts to support liability on these terms, relying instead only on a conclusory allegation (¶ 133) that constitutes nothing more than a "[t]hreadbare recital[]" of the Trustees'

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[15] In all likelihood, Plaintiff acquired "actual knowledge" of its claims far earlier than August 31, 2007. As described *supra* pages 3-6, the Fund publicly disclosed as early as 1998 that it *never* intended to perfectly track the Index and it repeatedly disclosed a gradual decrease in the amount of expected overlap between Fund and Index investments. To the extent that Plaintiff bases its breach of fiduciary duty claim on a failure to perfectly mirror the Index, Plaintiff had actual knowledge of this "failure" years before the class period even begins.

[16] In addition to being legally flawed, Plaintiff's argument is utterly unworkable. Although it claims 1% deviation would have been insufficient to provide "actual knowledge," Plaintiff's assertion begs the question as to what amount of deviation would be sufficient. The answer to that question might differ for every shareholder, which, at a minimum, would create an insuperable obstacle to class certification in this case.

state of mind. *Faulkner v. ADT Sec. Servs., Inc.*, 706 F.3d 1017, 1020 (9th Cir. 2013) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)). Because Plaintiff has failed to allege facts establishing anything beyond ordinary negligence, all the claims against the Trustees fail as a matter of law. *Blake v. Smith*, 22 Mass. L. Rptr. 173, at *11 (Mass. Super. Ct. 2006) (dismissing fiduciary duty claim against corporate directors because "plaintiff's well-pleaded allegations state no more than due care claims, which are barred by the exculpatory provision"); *see also Langer Juice Co. v. Stonhard*, 2014 WL 346643, at *11 (C.D. Cal. Jan. 30, 2014) (dismissing claims on a motion to dismiss based on "limitation of liability and limitation of remedies clauses").

VI. Plaintiff's Aiding And Abetting Claims Are Not Adequately Pleaded

Because Plaintiff has not adequately pleaded any claims for breach of fiduciary—and such claims are precluded by SLUSA even if they *were* adequately pleaded—Plaintiff's aiding-and-abetting claims (Claims 3-4, 10-11) must also be dismissed because such claims cannot be maintained in the absence of an underlying claim for breach of fiduciary duty. *See Arcidi v. Nat'l Ass'n of Gov't Emps., Inc.*, 856 N.E.2d 167, 174 (Mass. 2006). Further, the 4AC is devoid of factual allegations establishing that (1) any Defendant had actual knowledge that any other Defendant was breaching a fiduciary duty or that (2) any Defendant received such knowledge and decided to actively participate in the breach. *See Spinner v. Nutt*, 417 Mass. 549, 556 (1994) ("the plaintiff must show that the defendant knew of the breach and actively participated in it such that he or she could not reasonably be held to have acted in good faith").

CONCLUSION

For the foregoing reasons, the 4AC should be dismissed as to all Defendants with prejudice.

Dated: July 24, 2015

Respectfully Submitted,

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